BRIEFING MATERIALS ON THE ECONOMY

JOINT ECONOMIC COMMITTEE

Prepared for Congressman Jim Saxton

APRIL 1999

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Briefing on the Economy[1]

Summary and Overview

- The economy continues to expand at a healthy pace. The latest figures indicate that the economy's GDP expanded at a 6.0 percent rate in the fourth quarter of 1998, while many foreign economies remain weak or depressed. Key components of GDP -- consumption and investment -- remain strong and are generally supported by strong data for housing, employment, income and spending growth (although March payroll employment was weaker than expected).

- Sectors experiencing weakness continue to be in export-related businesses such as manufacturing, industrial production, agriculture, and commodity-based businesses.

- Almost all key measures of broad price movements continue to suggest no imminent resurgence of inflation is in the cards.

- Most forward-looking inflation indicators continue to indicate inflation will remain contained, although the long-term bond yield has increased relative to month-ago levels.

Role of Monetary Policy

- Federal Reserve monetary policy has produced many of the beneficial economic conditions we are experiencing today. Low inflation, low interest rates, low unemployment, and the consequent solid economic growth is the result of a gradual and credible disinflationary policy. To the extent governmental policy action has produced this benign set of circumstances, excellent monetary policy is the key reason.

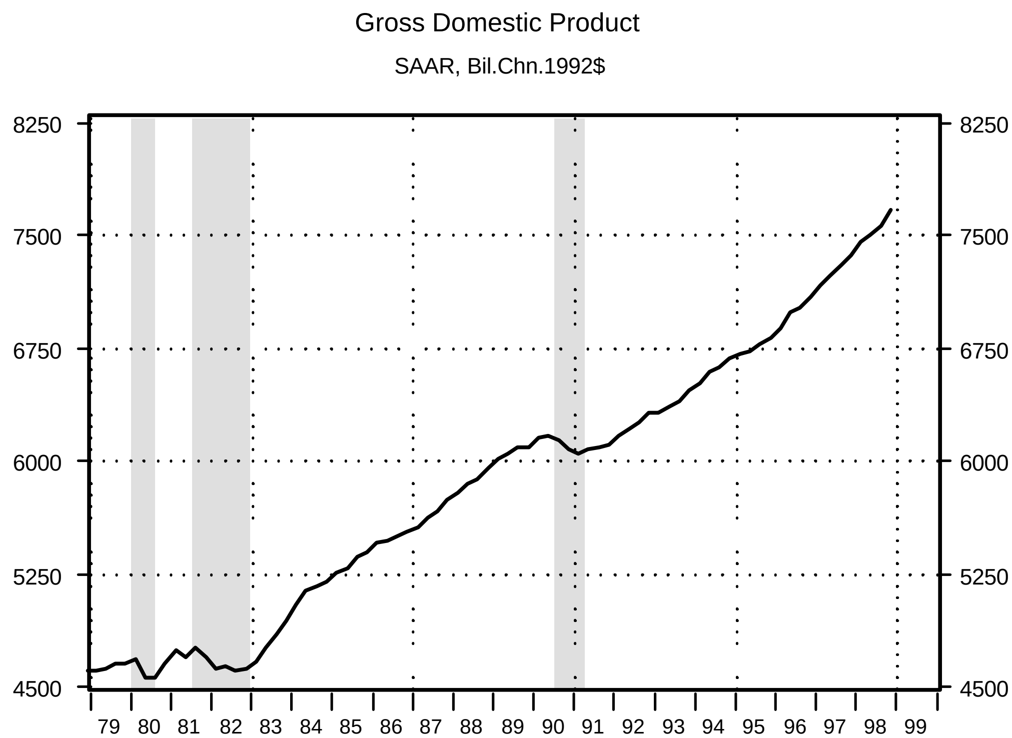
Outlook

- Consensus forecasts for 1999 have been revised upward indicating the expected economic slowdown has not materialized as earlier believed:

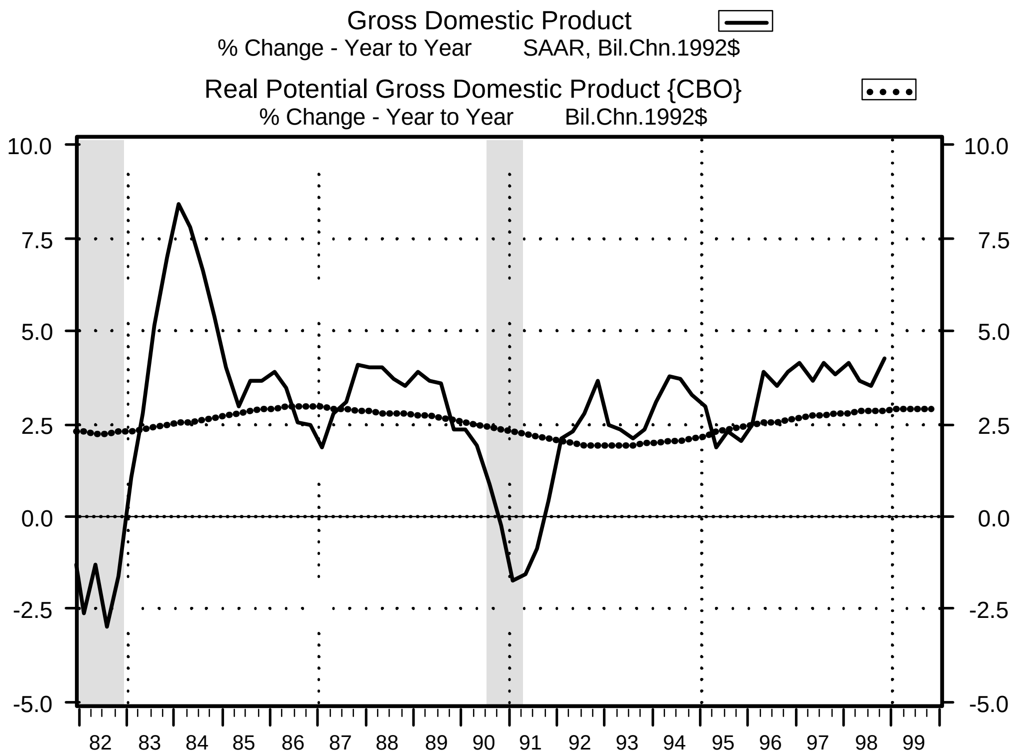
	Q1	Q2	Q3	Q4
Real GDP	2.9	2.5	2.4	2.7
Inflation	1.3	1.4	1.7	1.8

[1] The source for all graphs in these *Briefing Materials* is Haver Analytics.

I. Output Measures



- The current expansion is now eight years old (96 months) and the longest peacetime expansion on record.
- It followed a lengthy expansion in the 1980s, which lasted 92 months and is the second longest peacetime expansion on record.
- In short, we are now experiencing back-to-back the first and second longest peacetime expansions in American history.
- Even more remarkably, the recession that occurred between these record-breaking expansions was exceptionally short and mild (just 9 months).
- In sum, during the last 15 years not only did we experience the two longest peacetime expansions in U.S. history, but the only recession we had during these 15 years was remarkably short and mild.

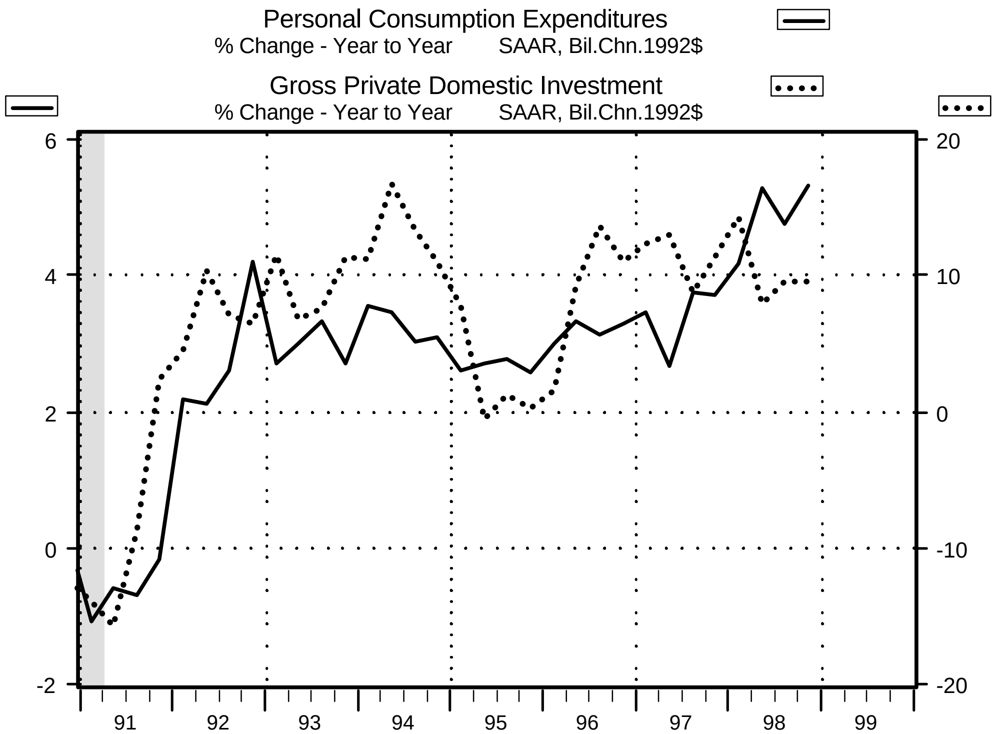


- This chart shows real GDP growth relative to "potential" growth as calculated by the Congressional Budget Office (CBO) since the early 1980s (on a year-over-year basis).

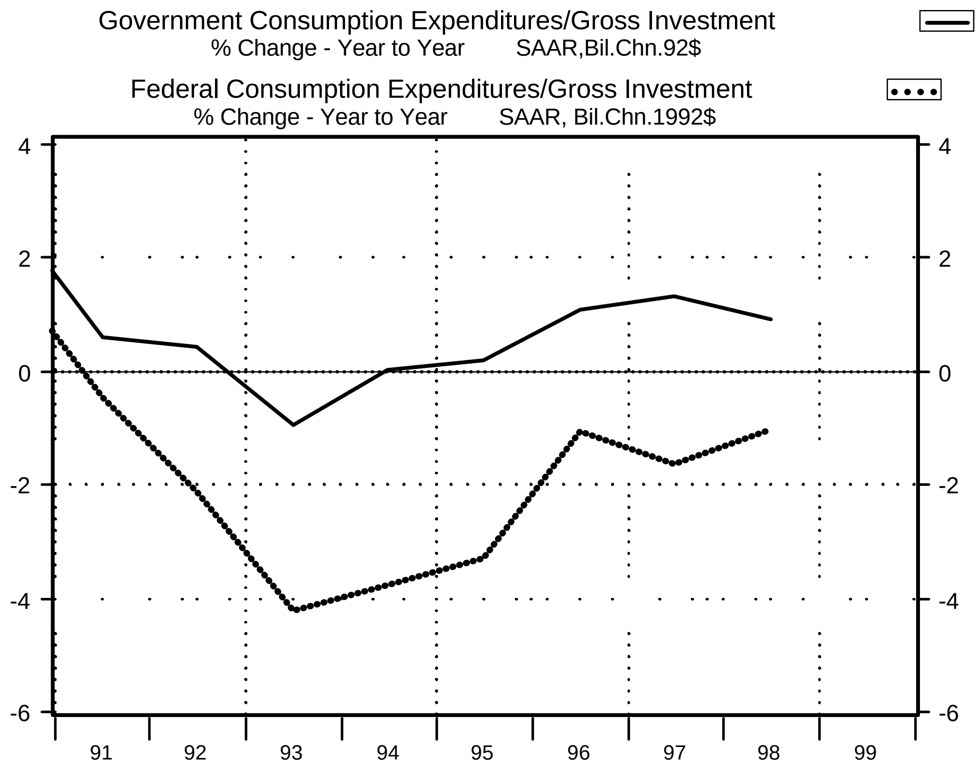
- The chart shows the above-mentioned 16-year period of unprecedented stability and virtually uninterrupted growth.

- As shown in the chart, real GDP has persistently tended to grow at a rate above its "potential" as calculated by CBO.

- Latest data indicate that real GDP continues to expand at a healthy pace. Real GDP grew at a 6.0 percent annualized rate in the fourth quarter.



- Both the consumption and investment components of real GDP have been leading sectors in this expansion. The figures in the chart are year-over-year figures.
- Note that the left axis pertains to consumption growth while the right axis pertains to the growth of investment.
- One reason for the strength of investment in this expansion is that the decline of inflation (see below) reduced interest rates and increased the real value of investment tax deductions.

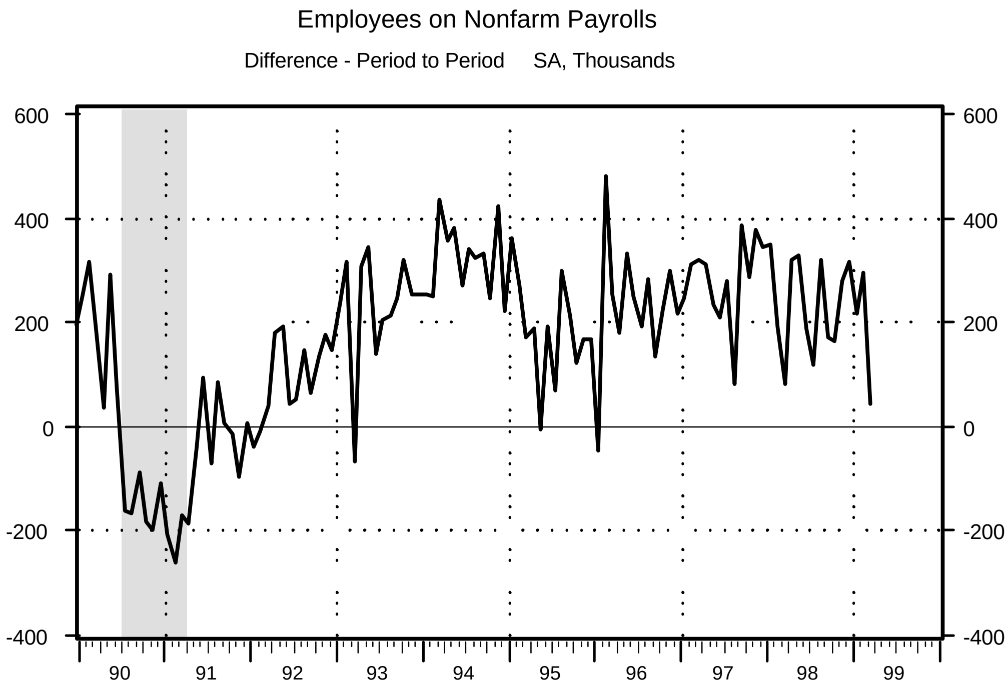


- One component of GDP that has not grown rapidly during this expansion is government spending on goods and services (this measure excludes transfer payments).

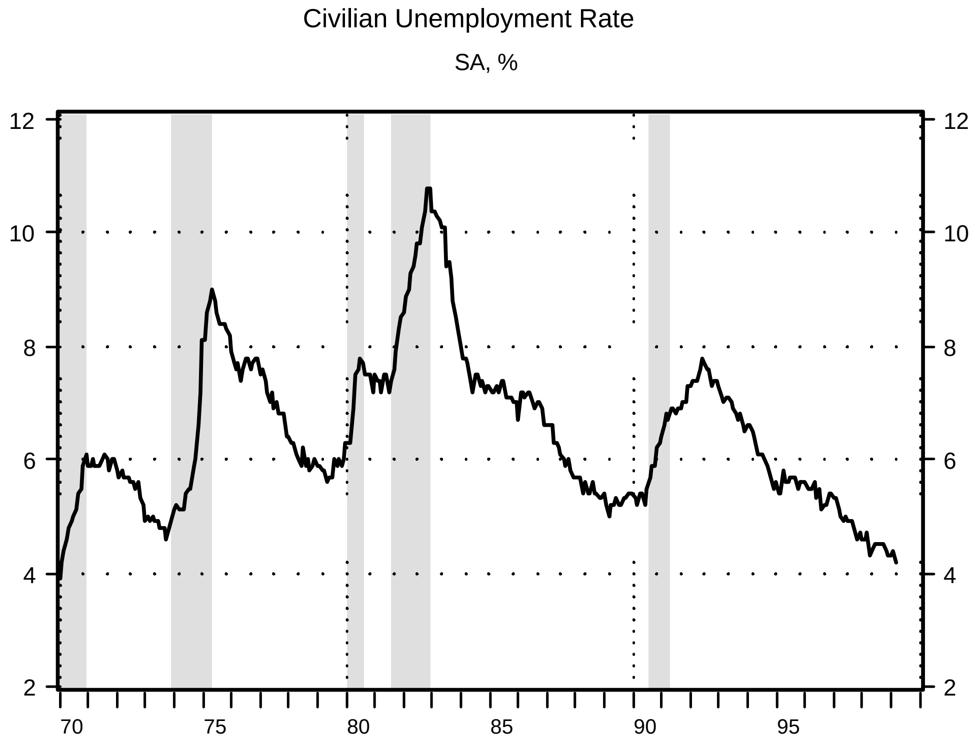
- Both total government (which includes state and local) and federal government spending on goods and services have been constrained during this expansion by growing less than GDP.

- Federal government spending on goods and services has actually declined in real (inflation adjusted) terms during this expansion. An important reason for this has been the cutbacks in defense spending.

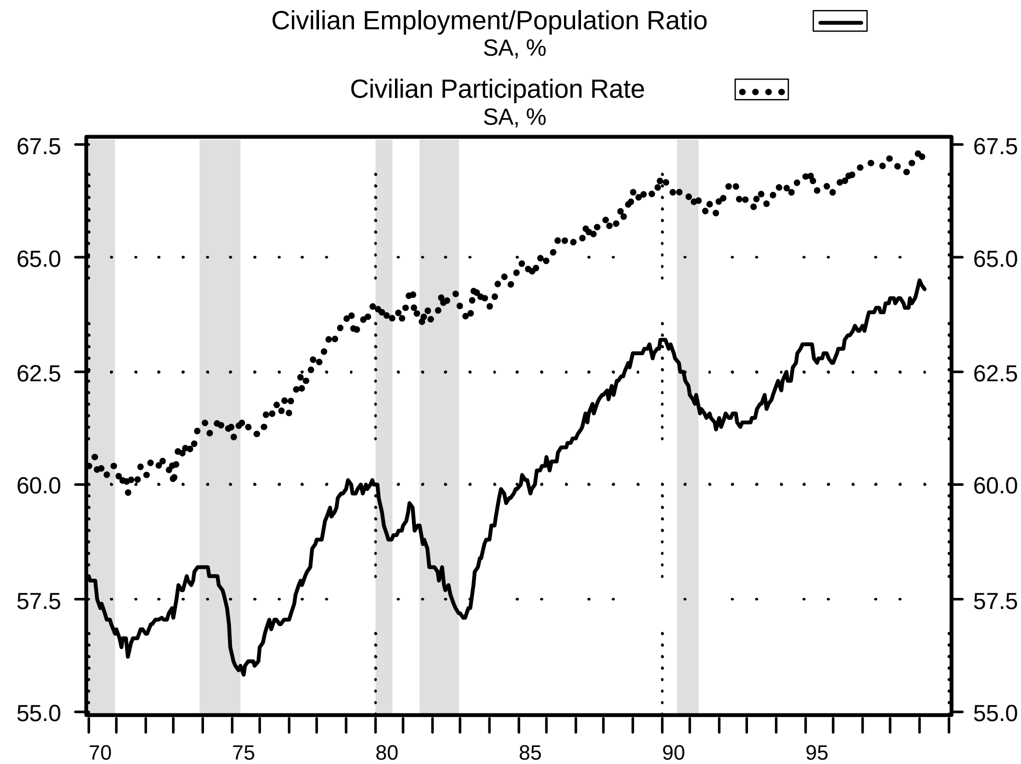
II. The Labor Market



- Employment gains during this expansion have been substantial with about 18 million new jobs added.
- In the last six years of this expansion, monthly payroll gains have averaged about 240,000 per month.
- Last month's gain was only 46,000, but this was considered to be a weather-related aberration. Employment in the weather-related construction industry, for example, actually fell substantially.



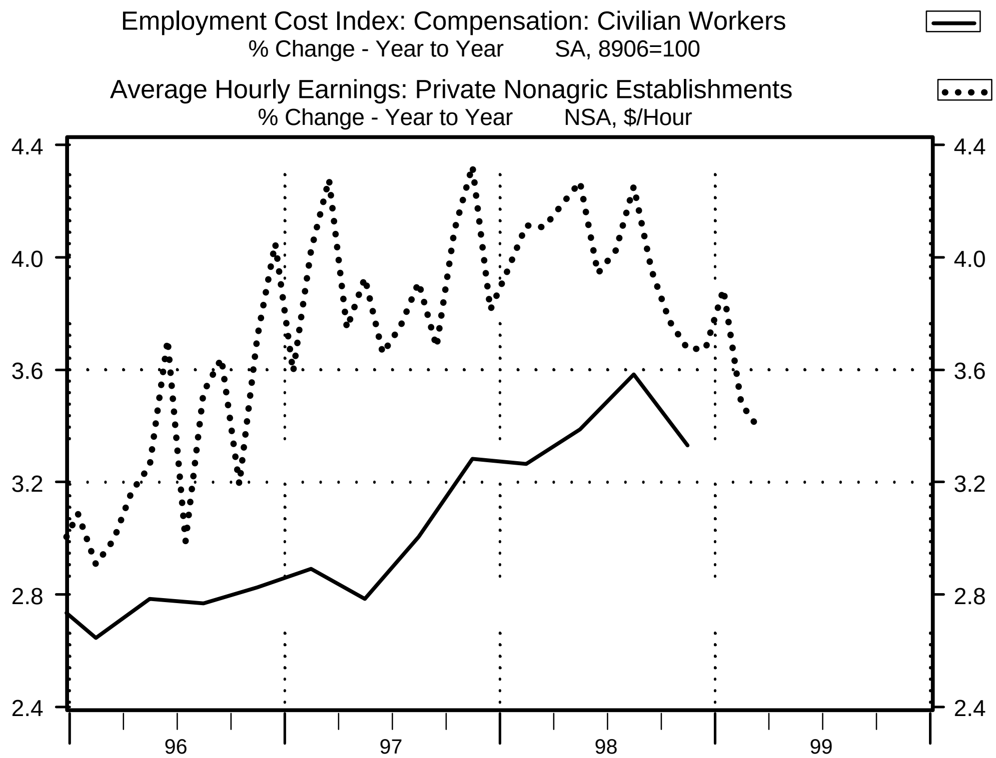
- The March unemployment rate fell to 4.2 percent, the lowest rate of unemployment since 1970!
- This unemployment rate is well below the so-called Nairu (non-accelerating inflation rate of unemployment), yet few signs of a resurgence of inflation are evident.



- Both the employment-to-population ratio and the participation rate remain close to all-time highs.

- The high employment-to-population ratio means that a higher proportion of the population has jobs now than in the past.

- The high participation rate means that more people are participating in the labor force (i.e., either have jobs or are seeking work) now than in the past.



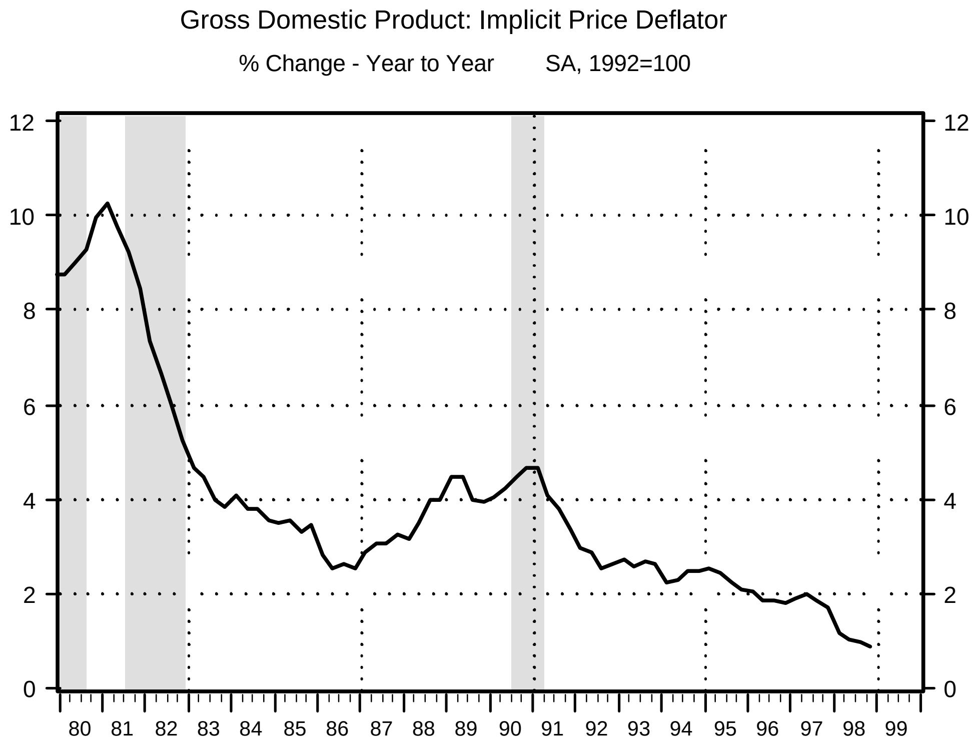
- Despite rapid job gains and a low unemployment rate, key measures of wage "inflation" have moderated from earlier periods.

- More specifically, March hourly earnings increased 0.2 percent over February and on a year-over-year basis slowed to a 3.4 percent rate.

- Similarly, year-over-year increases in the employment cost index fell to 3.3 percent in the fourth quarter.

- With productivity increases taken into account, these increases translate into modest wage cost pressures.

III. Inflation Measures

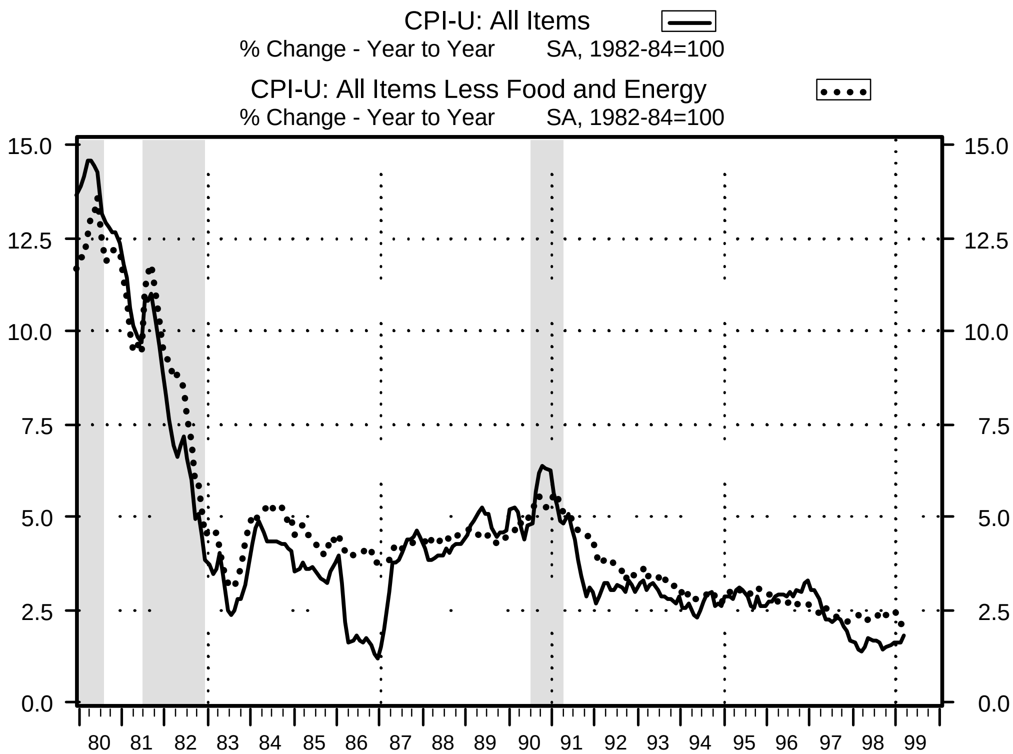


- Despite solid economic growth, inflation continues to be benign.

- This chart shows the broad GDP deflator, whose growth rate actually moderated slightly in the fourth quarter on a year-over-year basis.

- According to this measure, inflation is at its lowest level since the early 1960s.

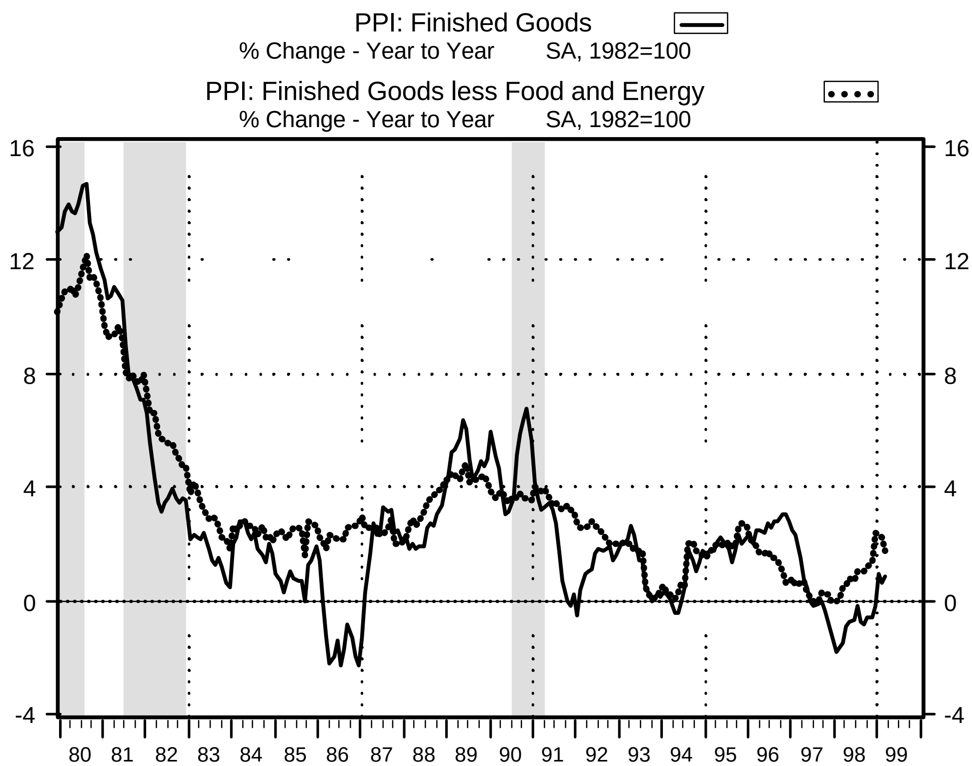
- This decline of inflation is due to Federal Reserve anti-inflation monetary policy which reduced inflation, lowered interest rates, and thereby fostered the economic expansion.



- Consumer price inflation has continued to post modest increases on a year-over-year basis.

- This graph shows that both the total (all component) CPI and the core (ex-food and energy) CPI have been well behaved.

- The latest (March) data shows this good performance continues. Total CPI increased 1.8 percent on a year-over-year basis while core CPI expanded 2.1 percent year-over-year, the lowest since 1966. Nonetheless, it is widely believed that recent energy price increases may cause some upticks in the CPI in the next few months.

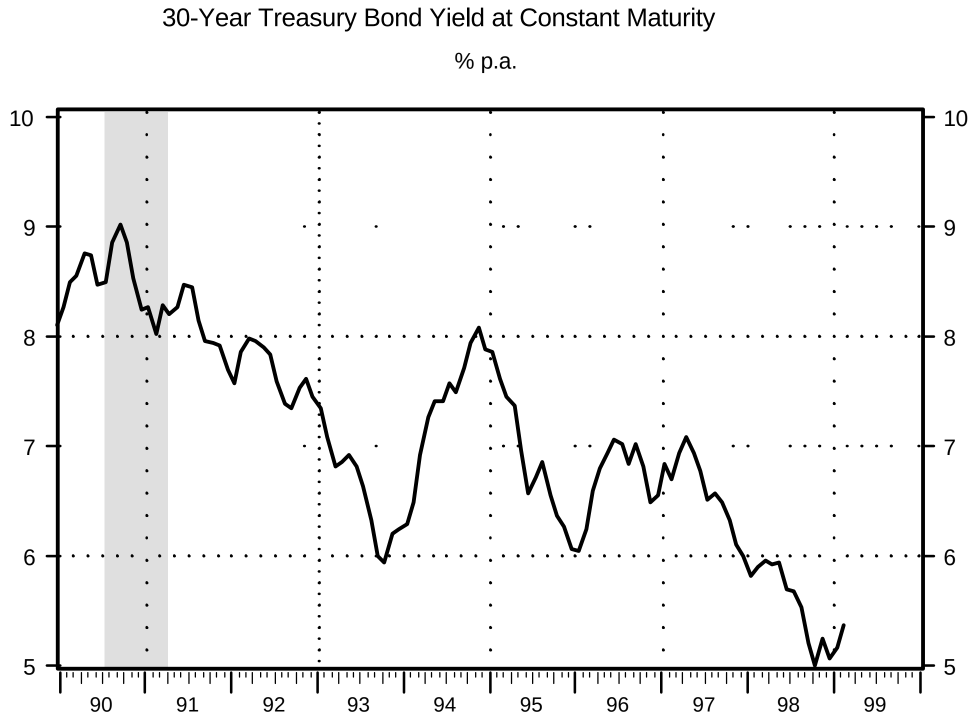


- Producer prices as measured by both the total finished good producer price index and the core (less food and energy) finished good producer price index have generally been well behaved.

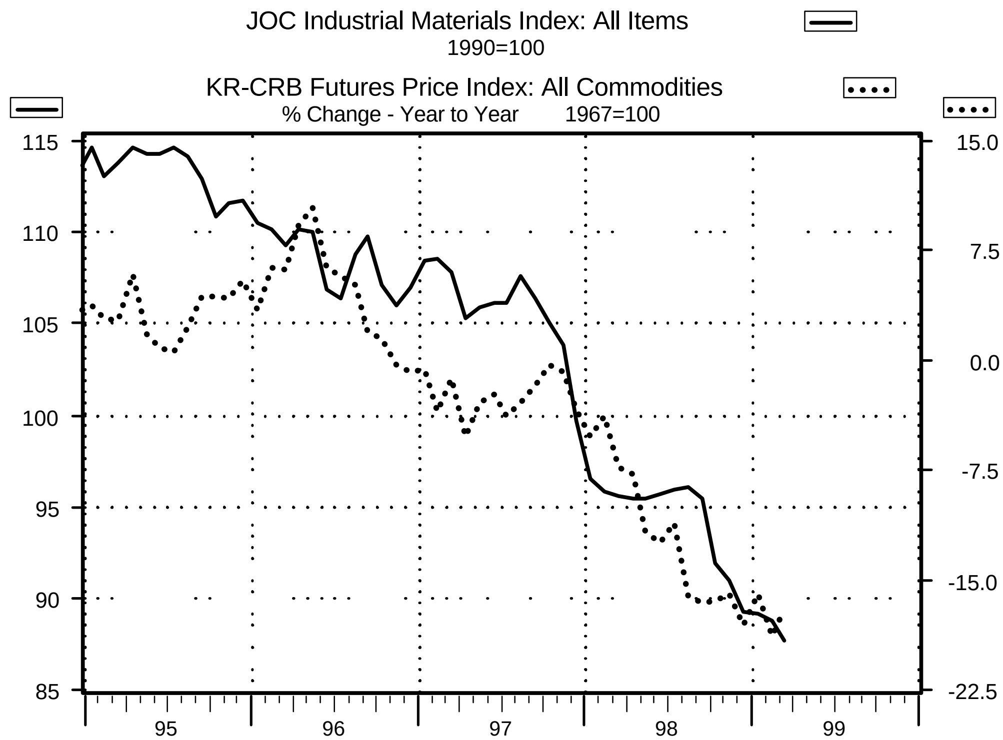
- Latest figures (March) indicate that the total PPI finished good category was up + 0.8 percent on a year-over-year basis.

- Recent upticks are largely accounted for by temporary factors such as abnormally sharp tobacco price increases and seasonal problems.

IV. Forward-Looking Market Price Indicators



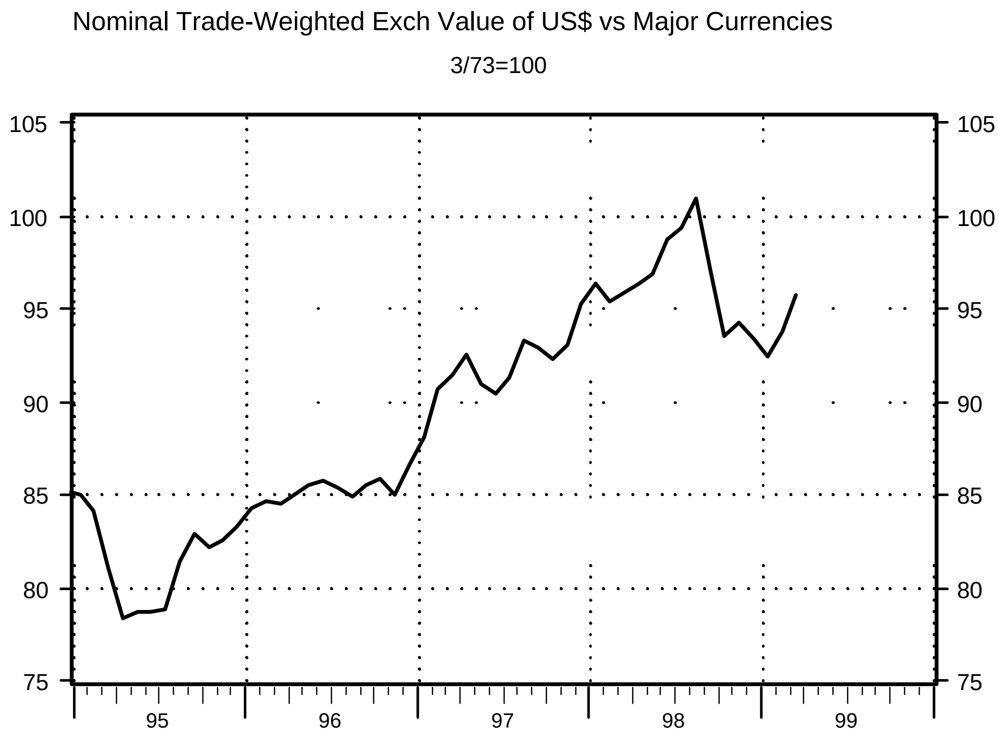
- Long-term interest rates have fallen in recent years.
- This chart shows the long-term bond yield.
- This rate has recently ticked up about 50 basis points due in part to market concerns about possible future Federal Reserve interest rate increases.



- Commodity prices remain quite weak. In fact, commodity prices have been falling in recent years.

- This chart shows two commonly used commodity price indices (the Journal of Commerce and CRB indices). Both of these measures have been falling for several years.

- There is no sign of any meaningful inflation resurgence from these measures of commodity prices.

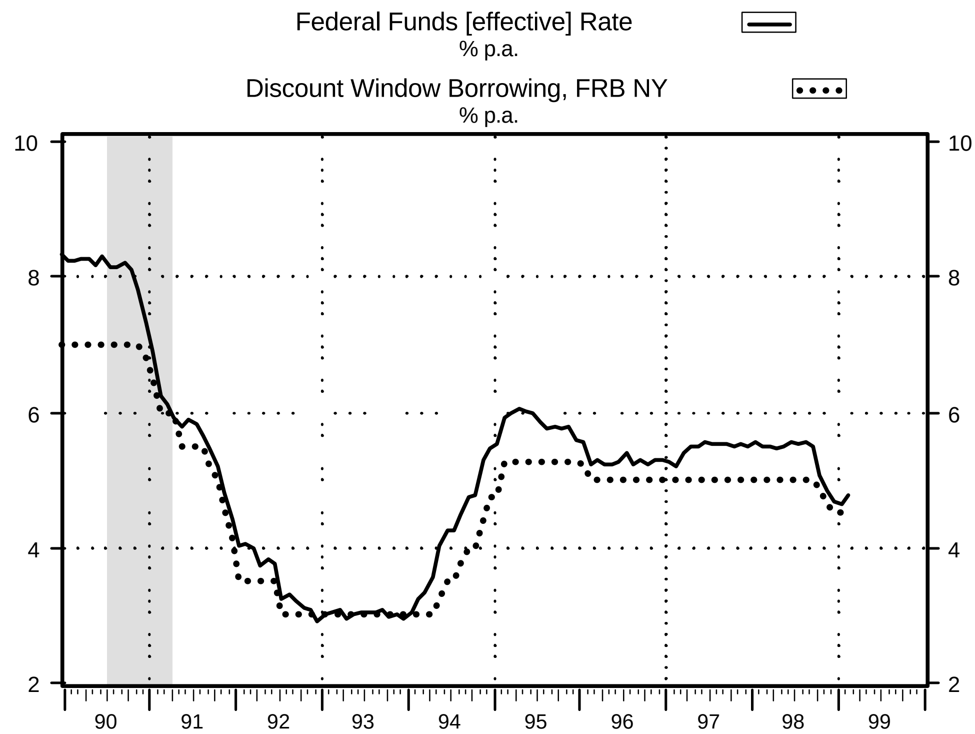


- The foreign exchange value of the dollar has generally trended up in recent years, although it dipped against a few individual currencies last year.

- The chart shows the trade-weighted value of the dollar against 17 major currencies.

- Recently, the dollar has strengthened against European currencies and the Euro.

V. Federal Reserve Monetary Policy



- Short-term interest rates are importantly influenced by Federal Reserve monetary policy.

- This chart shows the federal funds rate (an interest rate closely controlled by the Fed) as well as the discount rate (the rate the Federal Reserve charges banks for borrowing from the discount window).

- The Fed lowered the federal funds rate three times last fall, but has kept interest rates unchanged at its last three FOMC meetings. Furthermore, the Fed has maintained the unbiased directive that it adopted in November FOMC meeting.

- The next FOMC meeting is scheduled for May 18.

VI. Reasons for Circumstances of Healthy Growth with Low Inflation

Lower Inflation Actually Improves Growth.

- Lowers interest rates
- Reduces unnecessary uncertainty and volatility in financial markets
- Causes price system to work better
- Acts like a tax cut (especially for those portions of the tax code that are not indexed for inflation)

Government Spending has Fallen as a Percentage of GDP

- We have experienced a significant decline in federal government spending as a percent of total output. The federal government spent over 22 percent of GDP in 1992, compared with about 19.5 percent today.
- This enables resources to be used more productively, fostering more growth without inflation.

Lower Marginal Tax Rates Remain in Place.

- We are reaping long-run effects of lower tax rates (despite increases in 1990 and 1993)
- Marginal tax rates remain lower than they were in the 1950s, 1960s, and 1970s

Investment Has Worked to Expand Capacity.

- Investment in equipment has been a leading sector in this expansion
- This helps growth without causing inflation
- Information revolution/computers
- Technological Change has improved productivity

Global Competition and Freer Trade have Fostered Growth.

- Reduction in tariff barriers helps economic growth while promoting lower prices
- The international sector has increased in size and exports have been a leading sector in this expansion
- Inflation is declining in many countries
- The combination of global competition and technological change has corporate restructuring making the economy more efficient